

## ***Bill Analysis of SB 114 and 115***

**Bill Numbers:** SB 114 and SB 115

**Topic:** Allow conversions from one type of entity to another and restrict others; clarify availability of names where similarity exists.

**Sponsor:** Hansen Clarke

**Co-Sponsor:**

**Committee:** Commerce and Labor

**Date Introduced:** February 1, 2005

**Date Passed Senate:**

**Date Passed House:**

**Date Enrolled:**

**Date of Analysis:** March 10, 2005

**Position:** Neutral-Supported in concept, but implementation is a major problem for the bureau.

### **Problem/Background:**

An organization may wish to change business form to gain liability protection, flexibility, privacy or tax benefit. A corporation, limited liability company, or limited partnership may currently change business forms only by a merger or transfer of assets. A partnership may convert to a limited liability company, and such a change of business form by a statutory conversion is considered simpler than a merger or transfer of assets. Under current law, corporations cannot convert to LLCs, and LLCs cannot convert to corporations. Conversions would give business entities an additional option to use in business planning.

### **Description of Bill:**

The bills would amend the Michigan Limited Liability Company Act and Business Corporation Act to permit a corporation to convert to a LLC and permit an LLC to convert to a corporation. The entity that exists after the conversion is considered to be the same entity that existed before the conversion, and the conversion is not considered a dissolution of the prior entity.

The conversion bills are similar to provisions adopted in other jurisdictions and may provide additional flexibility for Michigan business entities. The bills do not address the state and federal tax implications of conversions.

The bills provide that the converted entity may use, as an assumed name, any name it used prior to conversion.

The bill clarifies that partners must approve the operating agreement and that the partnership agreement terminates on the effective date of the conversion.

#### **Arguments for:**

The conversion bills provide additional flexibility for Michigan business entities available in other jurisdictions but not available in Michigan. The ability to change from one entity to another by conversion allows business entities to do directly what they currently must do indirectly by merger or transfer of assets. In addition, the bills make it clear that the converted entity is the same entity that existed prior to conversion and can simplify business transactions.

A business changing its legal form, but not its activities, will be permitted to continue to use its prior names, similar to what is permitted in a merger, without filing a Certificate of Assumed Name.

SB115 improves the current provisions regarding conversion of a partnership to a LLC and clarifies what is needed to approve the conversion and to establish the LLC.

#### **Arguments Against:**

The use of an assumed name by a converted entity that uses a word connoting a different type of entity will be misleading to the public. For example, if ABC Inc. converts to an LLC, but continues to use ABC Inc., the public may be deceived.

It is unclear what the state and federal tax implications will be for a corporation converting to a limited liability company, or vice versa.

If the bills pass, the fees will be inadequate to cover the department's costs to implement the changes. Allowing conversions also represents a potential revenue loss by making it more attractive to convert an entity, rather than to merge, which currently costs approximately \$100 to \$150 per merger.

**SB 115** includes provisions regarding the conversion of a limited partnership to a limited liability company. The Revised Uniform Limited Partnership Act does not specifically provide for such conversions and must rely on the provisions in the Limited Liability Company Act.

**SB 115** includes language that indicates that a corporation providing services in a learned profession would be able to convert to a professional limited liability company. The Professional Service Corporation Act does not include authority for a professional service corporation to convert to a limited liability company or a professional limited liability company. To implement these provisions in SB115, the Professional Service Corporation Act must also be amended.

The National Conference of Commissioners on Uniform State Laws (NCCUSL) recently asked the Business Law Section of the State Bar of Michigan to review the Uniform

Limited Partnership Act (2001) for consideration and adoption in Michigan. In addition, it is anticipated that a comprehensive review of the Michigan Limited Liability Company Act will occur during the next 24 months. Review and consideration of expanding the conversion options would be appropriate to this broader review and would facilitate the proposal and adoption of uniform language, consistent with what other states are adopting.

Rather than proceeding with SB114 and SB115, the changes should be incorporated as part of a comprehensive revision of the statutes.

**Supporters:**

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**Opponents:**

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**Fiscal/Economic Impact:**

a) **Department:** Significant changes will need to be made to the Corporation Division's data base, certification programs, and image system to accommodate the conversion of corporations to limited liability companies and vice versa. At the present time, to provide adequate lead-time for the modifications to be made to the current data base, an effective date at least 1 year after the adoption of the bills is requested.

**Budgetary:**

Cost analysis from the Department of Information Technology in 2004, estimates it will cost DLEG \$61,140 to update the technology to accommodate conversions, with no estimated completion date.

We have no way to predict how many entities would choose to convert from one type of entity to another. In the last 12 years, currently permissible conversions have averaged 306 per year, and about 350 mergers were filed with the Corporation Division per year.

With updates to the technology, there is no anticipated increase in staff time to process conversions, since we expect them to be either partnership or limited partnership conversions, similar in number to what we now receive, or conversions instead of a merger.

However, if the bills are adopted before the Department of Information Technology can modify the database, it is estimated that the Corporation Division will require an additional 2-3 FTEs to process the conversions.

**Revenue:** Potentially 200-300 conversions would be filed each year. At \$25.00 each, the revenue to the department would be approximately \$5,000 to \$6,000. This new revenue will not begin to cover the department costs to implement the

changes, and may, in fact, represent a revenue loss by lowering the number of mergers processed.

**Comments:** If the process is implemented prior to technology changes, the department must be prepared to receive additional complaints about inaccurate information or slow response times to public requests for information.

**b) State of Michigan**

**Budgetary:**

**Revenue:**

**Comments:** A 2003 review of identical language in a prior set of bills by the Department of Treasury indicated that it is not possible to determine revenue impact without knowing how the entity elects to be treated for federal income tax purposes. A conversion from a partnership to a limited liability company that will be taxed as a partnership may have a different impact than a conversion from a limited liability company to a corporation or vice versa.

**c) Local Government:**

**Budgetary:** Unknown at this time.

**Revenue:** Unknown at this time.

**Other Pertinent Information:**

If the bills are enacted, the fees for conversion should be increased to not less than \$100.00, to avoid potential revenue losses. Even then, the potential revenue will not cover estimated costs to the department.

**Administrative Rule Impact:**

There is no administrative rule impact.